

REVISED DIRECT TESTIMONY

OF

JUDITH R. MARSHALL

TELECOMMUNICATIONS DIVISION

ILLINOIS COMMERCE COMMISSION

VERIZON NORTH, INC.

VERIZON SOUTH, INC.

(Formerly GTE North Incorporated and GTE South Incorporated)

DOCKET NO. 00-0812

PHASE I

DECEMBER 20, 2001

1 **Q. Please state your name and business address.**

2

3 A. My name is Judith R. Marshall and my business address is 527 East Capitol
4 Avenue, Springfield, Illinois 62701.

5

6 **Q. By whom are you employed and in what capacity?**

7

8 A. I am employed by the Illinois Commerce Commission ("Commission") as an
9 Economic Analyst in the Telecommunications Division.

10

11 **Q. Please describe your education, background and work experience.**

12

13 A. In 1978 I received a Bachelor of Arts Degree in Accounting and in 1981 I
14 received a Master of Arts, Business Administration Degree (later converted to an
15 MBA) from Sangamon State University, now known as the University of Illinois -
16 Springfield. I am a Certified Public Accountant, licensed to practice in Illinois.

17

18 I have approximately five years experience as an Internal Revenue Agent prior to
19 my employment by the Commission in 1982. Prior to assuming my present
20 position, I served as a Staff Accountant, an Audit Manager, and Supervisor of
21 Training in the Accounts and Finance Department and as Supervisor of the
22 Accounting Section in the Telecommunications Department of the Public Utilities
23 Division of the Commission.

24

25 I am a member of the American Institute of Certified Public Accountants and the
26 National Association of Regulatory Utility Commissioners ("NARUC") Staff
27 subcommittee on Education.

28

29 **Q. What is the purpose of your testimony in this proceeding?**

30

31 A. My testimony addresses the shared and common cost allocations related to the
32 integrated cost model ("ICM") and the Access Charges being addressed in
33 Phase I of this proceeding. In summary, I am in general agreement with the
34 formula used for allocation of common costs but do not agree with the amounts
35 of some costs that are included in the study. It is also important to re-calculate
36 the common cost allocator as a final step after all other adjustments to study
37 costs have been made. I find that Verizon North, Inc. and Verizon South, Inc.
38 ("Verizon" or "the Company") have not provided sufficient support for the
39 allocation of shared costs. Therefore, I recommend that the interim rate of
40 28.86% for both shared and common costs adopted by the Commission in
41 Dockets 98-0601 and 98-0602 continue to be used until Verizon revises the ICM
42 to address Staff's concerns.

43

44 **Q. Do any schedules and attachments accompany your testimony?**

45

A. Yes. Schedule 1 is the Shared Cost Report produced by version 4.4 of the ICM model. [Schedule 2 calculates the percentage of shared costs included in each TELRIC UNE.](#) Schedule 23 calculates Access Charges with and without shared costs. These calculations demonstrates the percentage of each charge that is due to the allocation of shared costs.

Q. Please discuss your general concerns with Verizon's allocation of Shared and Common Costs.

A. Both 83 Illinois Administrative Code Part 791 (hereafter "Part 791") and current TELRIC methodology require the use of forward looking costs. Part 791.20(c) defines forward looking costs as costs to be incurred by a carrier in the provision of a service. Forward looking costs ignore embedded or historical costs and are based on reasonable estimates. Part 791.80(f) provides that other service specific costs attributable to particular services or groups of services may be based upon historical costs if it can be demonstrated that those costs, in particular the estimated labor hours, are relevant to the study of forward looking costs.

Verizon's expense module of ICM utilizes 1999 historical costs with only minimal adjustments. These costs do not include any productivity gains experienced by Verizon since 1999. Verizon has not demonstrated that these historical costs are relevant to the study of forward looking costs. Therefore, I conclude that

Verizon's cost study submitted in this case is not in compliance with this requirement of Part 791.

Part 791.40(c)(4) requires that a LRSIC study reflect the demand for the entire service that is affected by the business or regulatory decision at hand. Part 791.60(b) provides that demand forecasts for new services shall reflect the total demand for the service, averaged over the projected revenue producing life of the service. Demand for telecommunications services tends to increase over time and any increase in demand will spread Verizon's shared and common costs over a larger pool of customers, resulting in a lower per unit cost. Verizon's use of historical demand data is not forward looking, and, accordingly, does not reflect any increase in demand, resulting in greater shared and common costs per unit.

In Illinois Bell Telephone Company d/b/a Ameritech Illinois Docket 96-0486 the Commission found that forecasted budget data should be used for TELRIC purposes. (Order, Docket 96-0486, pp. 35-54.) It is my opinion that budgeted data should be used to perform a forward looking study. Operating budgets for calendar 2003 should be available for use in this docket. Budgeted demand for the same time frame should be used to derive per unit costs.

Q. Do you also have specific concerns related to Verizon's cost study?

92 **A.** Yes, I do. The starting point of Verizon's calculation is 1999 ARMIS data and I
93 am concerned that this data contains costs that should not be borne by other
94 carriers. The Commission established guidelines in Docket 96-0486 when it
95 adopted the following specific adjustments and directed Ameritech Illinois to
96 recalculate its costs in accordance with the Commission's findings.

97 1. The costs of sporting events, skyboxes and White House dinners
98 were disallowed entirely.

99 2. Retail related expenses were removed from the common cost pool.

100 These included costs of printing customer bills, providing retail
101 customer account information, computer costs associated with
102 billing, correction and special handling of bills, and remittance of
103 Ameritech customer bills. (Order, Docket 98-0486, p. 35-54.)

104 In addition, it is my opinion that purchasers of access should not bear any portion
105 of sales, marketing or product related advertising costs. In essence, Verizon
106 seeks to recover advertising, marketing, and sales costs from its IXC customers.
107 Verizon should explain in its rebuttal testimony how each of these adjustments is
108 reflected in its calculation of shared and common costs. To the extent that
109 Verizon seeks recovery of these costs, it should provide a complete rationale for
110 their inclusion.

111
112 **Q. Did you discuss the specific adjustments the Commission ordered in**
113 **Docket 96-0486 with company witness Tucek?**

115 A. Yes, I did. Mr. Tucek responded that Verizon had not considered the
116 Commission's TELRIC Order in that case while developing its cost studies. He
117 was unable to determine the amount of cost included in Verizon's cost study
118 related to sporting events, but indicated that these costs were included in
119 Verizon's sales account. Mr. Tucek provided a model run which removes all non-
120 labor related sales cost from the study.

121 The uniform system of accounts ("USOA") defines account number 6612, Sales,
122 as costs incurred in selling products and services which includes determination of
123 individual customer needs, development and presentation of customer proposals,
124 sales order preparation and handling, and preparation of sales records. The
125 USOA also defines account number 6722, External Relations, including sub
126 section (c) "Performing public relations and non-product-related corporate image
127 advertising activities". (47 CFR Part 32.) In my opinion it is unlikely that costs
128 related to sporting events are included in Verizon's Sales account. Therefore,
129 the run provided by Mr. Tucek does not provide a reasonable estimate of these
130 costs.

131 Verizon should identify and quantify the costs of sporting events, skyboxes,
132 White House dinners, other non-product-related corporate image advertising
133 activities, retail related expenses, sales, marketing and product advertising
134 expenses included in its cost studies. Generally, these types of cost should not
135 be recovered from other carriers in competition with Verizon. Verizon should fully
136 support and justify any amount of these costs that are related to serving other
137 carriers.

138

139 **Q. How has Verizon calculated the amount of shared costs included in the rate**
140 **of each element or service?**

141

142 A. It is not clear from Verizon witness Tucek's testimony or my own review of the
143 documentation provided in support of the integrated cost model ("ICM") exactly
144 how Verizon has calculated the amount of shared costs included in the rate of
145 each element or service. Schedules [2](#) and [3](#) attached to this testimony illustrates
146 the wide variance in the percentage mark-ups for shared costs related to the
147 provision of [UNEs and](#) access services. For some services the mark-up appears
148 to be unreasonably high. Verizon should provide detailed information supporting
149 its mark-ups for shared costs and verify how each item of shared cost is related
150 to the service to which it is assigned.

151

152 To the extent that shared costs are allocated using an expense to investment
153 ratio, it will also be necessary to re-calculate those ratios to incorporate any other
154 changes to Verizon's cost studies that may be required. This step should be
155 performed after all adjustments or updates to amounts of expense and
156 investment have been determined and immediately before the calculation of the
157 common costs allocator.

158

159 **Q. Is there other evidence that the allocation of shared costs utilized by**
160 **Verizon is unreasonably high?**

161

162 A. Yes, there is. Other states have recently investigated Verizon's calculation of its
163 Shared and Common Costs and determined that much lower amounts of Shared
164 and Common Costs are appropriate. For example, Michigan reduced Verizon's
165 calculation of Direct Costs, as well as Shared and Common Costs by 20%.
166 (Michigan Order, Docket U-11832, pp. 5-7.)

167

168 **Q. How did Verizon calculate the amount of common costs included in the**
169 **rate of each element or service?**

170

171 A. To develop a common cost rate, the long run service incremental cost ("LRSIC")
172 of each service or the total element long run incremental cost ("TELRIC") of each
173 service or element was multiplied by a common cost allocator of 12.39%, which
174 results from dividing Total Common Costs by Total Direct Costs. (Verizon Direct
175 Attachment TD-1).

176

177 **Q. Has Verizon updated its calculation of the common costs allocator?**

178

179 A. Yes. The originally filed Direct Attachment TD-1 calculated the Common Costs
180 Allocator (Factor) to be only 11.23%, using the same formula. The increase in
181 the Common Costs Factor is due to reductions in the amount of Total Direct
182 Costs reflected in the denominator. The amount of Total Common Costs

reflected in the Numerator in this formula are unchanged in Direct Attachment TD-1.

Q. Please comment on the formula used by Verizon to calculate the Illinois Common Cost Allocator.

A. I am in agreement with the basic formula used by Verizon to calculate the Illinois Common Cost Allocator or Factor. However, Verizon's own revision of this factor illustrates the importance of reflecting any change in the amount of directly assigned costs, including shared costs, in the calculation. Therefore, it will be necessary to re-calculate the Common Costs as a final step after all other changes or adjustments to Verizon's study have been finalized.

Q. Please discuss how Verizon's Common Costs Study deals with the issue of merger related savings.

A. The Common Costs Study incorporates a reduction in costs to reflect 50% of net merger savings as estimated by Verizon. In my opinion, all of Verizon's net merger savings should be reflected as a reduction of costs. In addition, Verizon reduced its calculation of net merger savings by an amount of savings that it believes would occur due to process re-engineering regardless of whether the merger occurred. (Docket 98-0866, Bell Atlantic/GTE Exhibit 4.0, p. 5 and p. 18).

Cost reductions due to process re-engineering should also be fully reflected in Verizon's Cost Studies.

Q. Are you recommending that the 12.39% common cost factor developed by Verizon be utilized in this docket?

A. No. I cannot recommend use of this factor because I believe that there are serious flaws in the Common Cost Study that should be corrected and that a revised factor should be used. Verizon should make the appropriate modifications to its Cost Study and develop a corrected and more current revised factor.

Q. Please discuss the issues in Verizon's Shared and Common Cost Studies which you have identified.

A. Based upon my review of Verizon's Shared and Common Cost Studies, I have the following concerns.

1. The studies are not based on forward looking budgeted data as was adopted by the Commission in Docket 96-0486.
2. Verizon should incorporate forward looking demand data into its study of shared and common costs.
3. Verizon should also demonstrate that its current study properly reflects the expenses disallowed by the Commission in the initial

TELRIC case, Docket 96-0486.

4. Verizon should provide a complete rationale for any sales, marketing and product advertising expenses included in these studies.

5. Allocation of shared costs is not sufficiently explained in either the study or the Documentation and User Manual.

6. The amounts included for merger related costs and savings should be updated to reflect the forward looking going level net merger related savings and capital savings.

7. The Common Cost Allocator should be re-calculated as a final step after all other cost levels have been finalized.

Verizon should address each of these concerns in its rebuttal testimony and when revising its shared and common cost study to a forward looking study. The burden of proof lies upon the Company to establish complete cost support for its proposed rates. Each party to the case should be given the opportunity to address Verizon's revised study in the future phases of this case.

Q. Please summarize your recommendations.

A. Verizon should perform a current study of shared and common costs that is in compliance with the Commission's Order in Docket 96-0486 and addresses each of the concerns I have listed above. This study should be forward looking and

251 based on preliminary estimated budget data as ordered by the Commission in
252 that docket. Staff believes that preliminary budget data for 2003 is now available
253 and I recommend that the most forward looking preliminary budget data available
254 be used. The study should be addressed in this docket.

255
256 The amounts of merger costs and savings utilized in each of the cost studies
257 should reflect current estimates of net merger related savings. Merger related
258 costs and savings should be reflected in that study at a forward looking, going
259 level.

260
261 In the event that Verizon does not provide a current, forward-looking study of
262 shared and common costs, the current interim rate of 28.86% shared and
263 common cost factor should remain in effect.

264
265 **Q. Does this conclude your testimony?**

266
267 **A.** Yes, it does.
268

268

Schedule 1

269

270

271

THIS SCHEDULE CONTAINS PROPRIETARY DATA

272

272

Schedule 2

273

274

275

THIS SCHEDULE CONTAINS PROPRIETARY DATA

276

|

276

[Schedule 3](#)

277

THIS SCHEDULE CONTAINS PROPRIETARY DATA

278

279